

Service Date: June 13, 1985

DEPARTMENT OF PUBLIC SERVICE REGULATION  
BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MONTANA

IN THE MATTER Of The Application )	
Of BUTTE WATER COMPANY To Increase )	UTILITY DIVISION
Water Rates And Modify Rules And )	DOCKET NO. 84.9.57
Regulations For Its Butte, Montana )	ORDER NO. 5114a
<u>Customers.</u> )	

ERRATA SHEET TO ORDER NO. 5114a

Ordering paragraph No. 1, line 2, page 20 should read  
\$238,446 rather than \$285,796.

Service Date: June 11, 1985

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OF THE STATE OF MONTANA

IN THE MATTER Of The Application )	UTILITY DIVISION
Of BUTTE WATER COMPANY To Increase )	DOCKET NO. 84.9.57
Water Rates And Modify Rules and )	ORDER NO. 5114a
Regulations For Its Butte, Montana )	
Customers. )	

APPEARANCES

FOR THE APPLICANT:

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FOR THE INTERVENORS:

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FOR THE COMMISSION:

Opal Winebrenner  
Staff Attorney  
2701 Prospect Avenue  
Helena, MT 59620

BEFORE:

John Driscoll, Commissioner  
Howard Ellis, Commissioner  
Tom Monahan, Commissioner

BACKGROUND

1. On September 21, 1984, Butte Water Company (Applicant or BWC) filed an application with the Montana Public Service Commission for authority to increase rates and charges for water service to its customers in Butte, Montana. The Applicant requested an average increase of approximately 13.02%, which constitutes a revenue increase of approximately \$366,944 annually. The Applicant also requested modification of certain rules and regulations applicable to its utility operations.

2. Concurrent with its filing for a permanent increase in rates, BWC filed an application for an interim increase of approximately 3.60% for a revenue increase of approximately \$101,622, or 27.6% of the proposed permanent increase.

3. On January 9, 1985, the Commission having considered the data filed with the Applicant's interim application, issued Order No. 5114 granting the Applicant interim rate relief in the amount of \$101,622 annually.

4. On February 13, 1985, pursuant to notice of public hearing, a hearing was held in the Montana Tech Student Union Building, Butte, Montana. The purpose of the hearing was to consider the merits of the Applicant's proposed water rate adjustment and rule modifications.

#### FINDINGS OF FACT

5. At the public hearing, the Applicant presented the testimony and exhibits of:

Gary Mannix, President and General Manager, BWC

Don Cox, Certified Public Accountant

David Johnson, Certified Public Accountant

6. The Montana Consumer Counsel presented the testimony of one public witness, Walter Richter, Chairman of the Rocker Water and Sewer District. Mr. Richter requested that the Commission authorize a reduction in the rate assessed the Rocker Water District for all purchases of water from BWC, which is the District's only source of supply.

7. The year ending December 31, 1983, test year was uncontested and is found by the Commission to be a reasonable period within which to measure the Applicant's utility revenues, expenses and returns for the purpose of determining a fair and reasonable level of rates for water service.

#### DEVIATION FROM GENERAL RATEMAKING PRINCIPLES OF THE PSC

8. It is the Commission's policy to evaluate the need for increased rates to private utilities, through analysis of

rate base, operating revenues and expenses, depreciation, taxes, capital structure and rate of return. This Commission's policy has developed over many years and embraces all privately-owned public utilities under its jurisdiction.

9. BWC is a privately-owned public utility, but the Applicant has requested that this Commission authorize increased rates on a cost basis similar to the treatment afforded municipal utilities under this Commission's jurisdiction. Specifically, the Applicant has requested that the Commission treat interest costs as an operating revenue deduction and grant sufficient revenues to cover these costs as an "above the line" item.

10. The Applicant's request for a deviation from general rate-making principles stems from the fact that a significant disparity exists between the Applicant's debt component of capitalization and its rate base. This disparity (debt exceeding rate base), in the Applicant's view, warrants deviation from general principles because traditional rate-making (application of a rate of return on rate base) will not generate sufficient net operating income to cover the actual cost of the Applicant's debt. BWC's debt exceeds rate base because the Applicant has approximately \$1.1 million in the debt component of the capital structure for the financing of past operational losses (Tr. pgs. 59 & 68). The past operational losses of \$1.1 million are reflected in the Applicant's capital structure in the following manner; \$500,000 is included in the debt due and payable, to ARCO and the remaining \$600,000 is the proposed note payable to Anaconda Minerals.

While the Commission may ultimately agree that a deviation

from general rate-making principles is warranted, it is of the opinion that the Applicant's filing should be examined from a traditional point of view before making a determination relative to the need for deviation.

#### CAPITAL STRUCTURE

11. For rate case presentation: the Applicant presented (the following capital structure, in "Data Furnished in Compliance with PSC Minimum Rate Case Filing Requirement, Statement F"

<u>Description</u>	<u>Amount</u>	<u>Ratio</u>
<u>Debt</u>		
ARCO Note	\$3,888,889	110.35%
Anaconda Minerals	600,000	17.02%
<u>Equity</u>	<u>(964,610)</u>	<u>(27.37%)</u>
TOTAL	\$3,524,279	100.0%

The capital structure proposed by the Applicant was questioned relative to the \$600,000 note payable to Anaconda Minerals, BWC's parent company.

12. The Anaconda Minerals note is new and is being presented for the first time in this Docket. Applicant's witness, Gary Mannix, described the circumstances that necessitated the position of funds, from the parent, in his prefiled testimony, as follows:

"...we began experiencing a serious cash flow problem in September of 1983 which has not corrected itself and will produce an estimated cash short fall of \$600,000 as of December 31, 1984. In order to pay our bills, we have been advanced funds in the amount of \$387,000 by Anaconda Minerals

Company as of August 31, 1984. These advances have been formalized into a promissory note in the amount of \$387,000, bearing interest at the rate of 14.04% per annum from and after September 1, 1984."

"We have included the annual interest cost on the estimated balance as of December 31, 1984 in our current application."

At the hearing, Mr. Mannix responded to a series of questions regarding the advancement of funds by Anaconda Minerals and the use those funds were put to by BWC. At pages 22 and 23 of the transcript Mr. Mannix responded to questioning as follows:

Q. Mr. Mannix, in your opinion, does the provision of advanced funds by Anaconda Company to Butte Water Company, is that a method for Butte Water Company to have its losses financed, losses that is experienced during this period that we have discussed?

A. If they had not advanced us funds, we wouldn't be operating, or I'm not sure how we would be operating.

Q. Let's try the question again. Do you consider those advances as a method of Anaconda financing the losses as Butte Water Company has experienced?

A. Yes

Q. It's my understanding of the proposal and the uniqueness of your filing in this docket, that Butte Water is proposing to carry the advances that have been received from Anaconda as an interest bearing note payable and that you request that interest be above the line so that you could get a return

through the rates or opportunity for a return through the rates. Is that not correct?

A. We're looking for a return to offset all of our expenses including interest.

At page 40 of the transcript, when Mr. Mannix was questioned why the Anaconda advances were converted to a debt instrument, he responded as follows:

Q. Then you said earlier the decision to make it all debt was a good business decision. Why do you believe that?

A. It had been done previously and recognized by the Commission in an order.

When questioned whether BWC and Anaconda considered the Mr. Mannix responded in the advances taking the form of equity, Mr. Mannix responded in the following manner, on page 43 of the transcript:

Q. Mr. Mannix, I wasn't clear in your responses to Mr. Driscoll, was anything other than pure debt ever considered or thought of or did you just routinely say: We have to get some more money, we'll borrow it in the form of a note?

A. There were a lot of items discussed. We felt that was probably the best way to stop the cash flow drop and make the Company stable.

Q. Specifically, then did you discuss the possibility of the contribution being in the form of equity?

A. No, I didn't.

Q. You didn't?

A. No.

13. From the excerpts of the testimony in the previous finding it can be seen a number of concerns were expressed regarding the treatment afforded funds advanced by Anaconda Minerals to BWC. The conversion of the advances, which were used to cover operating losses, to a note payable bearing interest at the rate of 14.04% per annum, was the subject of memorandums submitted by the Applicant and the Montana Consumer Counsel, subsequent to the close of the hearing in this Docket.

The memorandums submitted by the parties were to address the issue of whether or not the collection of interest on the note payable to Anaconda Minerals, the proceeds of which were used to cover operating losses, was prohibited by the "no past-loss" rule. Both parties concluded in their memorandums that recovery of the interest expense, associated with capital obtained to cover past losses, is not prohibited by the "no past-loss" rule. The conclusion, drawn in the memorandums indicates that treatment of the advances as a note payable is one of the options available to the Commission. The Commission is now cognizant of another option, however, which was discussed during the hearing, and that is treatment of the advances as an equity infusion by the equity investor, Anaconda minerals. The Commission is of opinion that this option should be explored before making a determination as to the appropriate treatment that should be afforded the advances.



14. BWC is a wholly owned subsidiary of Anaconda Minerals(AM), thus AM is the sole equity investor in BWC. This parent-subsubsidiary relationship raises questions regarding the appropriate treatment that should be afforded the \$600,000 in advances that have been reflected as a note payable in the capital structure of BWC.

Until September 1, 1984 the funds advanced by AM to the Applicant were carried on the books as an Account Payable; at that time the advances were converted to a Note Payable, and assigned an interest rate of 14.04%. The funds advanced by AM to the Applicant were used to cover operation and maintenance expense of the utility i.e., payroll, property taxes, etc.

Traditionally, the funds reflected in the capital structure of a utility reflect monies used to acquire assets that are used and useful in the provision of service to the consumers and, therefore, those funds are properly considered in determining the overall cost of capital for a utility. In this instance, the funds advanced by AM to the Applicant were not a traditional use of , in essence the funds advanced were used to cover operating losses of the Applicant.

15. The incurrence of an operating loss would normally result in a reduction of the equity component of the capital structure, with that loss being absorbed by the equity investor. This loss is absorbed by the equity investor through the diminished dollar return that will be received from the decrease in equity.

In the instance where an operating profit is generated the equity component of the utility's capital structure would increase, assuming the entire profit is not declared for

dividends. With the increase in equity, the equity investor receives the benefit from increase holdings in the company on which the utility ratepayer will pay a return.

16. In the application pending before the Commission, BWC's equity investor, AM, is willing to absorb the \$600,000 operating loss of its subsidiary through reflection of a decreased equity in the Company. AM wants the ratepayer to pay a return to it, however, in the form of interest expense, by converting advances made to BWC, to cover operating losses, to a note payable. Operating losses are a normal business risk and are properly born by the equity investor both as to the decrease in equity and in the diminished return associated with the reduction in equity.

17. The Commission realizes that the Applicant has requested that the advances, from AM to BWC, be handled in a manner consistent with that authorized by the Commission in Docket No. 81.3.25, Order No. 4801a. In that order, the Commission allowed the Applicant to convert approximately \$500,000 in advances from Anaconda Company, which were used to cover operation and maintenance expenses, to an interest bearing note payable. The Commission must now conclude the decision in that case was based on an inadequate record and did not fully analyze the responsibility of ratepayers versus equity investors.

18. It is the Commission's opinion that it is not the responsibility of the ratepayer to reimburse the equity investor for the carrying costs associated with funds advanced for covering operating losses of the utility, since those monies were not used to acquire assets that are used and useful in the provision of service to the consumer. If there is an expectation that carrying charges associated with

operating losses are the responsibility of the ratepayer then recognition of this shared responsibility must be recognized when operating profits are earned by the utility. The proper treatment that should be afforded operating profits, under the shared responsibility concept, would be exclusion of those profits from the Applicant's cost of capital calculation.

Since, in the Commission's view, there is not a sharing of responsibility relative to operating profits and losses, it is appropriate to deem the \$600,000, in advances from the equity investor as an equity infusion and reflect the infusion in the capital structure of the Applicant.

19. The Commission finds the following to be the appropriate capital structure this Docket:

<u>Description</u>	<u>Amount</u>	<u>Ratio</u>
<u>Debt</u>		
ARCO Note	\$3,888,889	110.35%
<u>Equity</u>	<u>(364,610)</u>	<u>(10.35%)</u>
TOTAL	\$3,524,279	100.00%

#### COST OF DEBT

20. The debt capital of the Applicant consists of a loan from the Atlantic Richfield Company (ARCO), its parent, having a term of 10 years and carrying an interest rate of 14.04 percent with an annual interest payment, attributable to the Butte Division of BWC, in the amount of \$525,470. This loan arrangement was executed between the parties (BWC & ARCO) in compliance with this Commission's Order No. 4801a, wherein the Commission found the loan arrangements then in existence

were imprudent. The Commission finds the cost of this debt to be reasonable and is accepted by the Commission.

#### CAPITAL STRUCTURE AND COMPOSITE COST OF TOTAL CAPITAL

21. The Commission finds the following capital structure and composite cost of total capital to be reasonable:

<u>Description</u>	<u>Amount</u>	<u>Ratio</u>	<u>Cost</u>	<u>Weighted Cost</u>
Debt	\$3,888,889	110.35%	14.04%	15.49%
Equity	<u>(364,610)</u>	<u>(10.35%)</u>	<u>14.04</u>	<u>(1.45%)</u>
Total	\$3,524,279	100.00		
Composite cost of Total Capital				14.04%

#### RATE BASE

22. Exhibit B (DC-1), page 2 of 2, is a representation of the Applicant's original cost depreciated rate base. The Applicant's original cost depreciated rate base as represented on this exhibit is \$3,407,440. The rate base calculation presented by the Applicant was not challenged by any party participating in this proceeding and, therefore, is accepted by the Commission.

#### OPERATING REVENUE

23. The test period operating revenues are not a contested issue in this case. The Applicant utilized the 12 months ended December 31, 1983, to determine the test period revenues under the rates which became effective March 19, 1984, and adjusted for loss of sales to Anaconda Minerals and the phasing in of charges to consumers previously receiving free water service. Total test year revenues of \$2,788,576, as calculated by the Applicant, are accepted by the Commission.

## OPERATING EXPENSES

24. The Applicant in its application, proposed proforma adjustments to operation and maintenance expense increasing these expenses by \$23,446. The claimed increases in operating expense were examined during the course of the hearing in this Docket and were supported by the testimony of the Applicant's witnesses. The Commission accepts the increase in operation and maintenance expense presented by the Applicant and finds total proforma operation and maintenance expense to be \$2,239,434.

25. Depreciation expense is found to be \$102,346.

26. Taxes other than federal income are found to be \$206,837.

27. Total operating revenue deductions are found to be \$2,548,617.

28. Operating income is found to be \$239,959:

Operating Revenue	\$2,788,576
Operating Deductions	<u>2,548,617</u>
Operating Income	\$ 239,959

Butte Water Company - Docket No. 84.9.57 - Order No. 5142

## REVENUE REQUIREMENT (TRADITIONAL)

29. In order to produce a return of 14.04% on the Applicant's average original cost depreciated rate base, the Applicant will require additional annual revenues in the amount of \$238,684 from its Butte, Montana water utility.

Rate Base	\$3,407,440	
Rate of Return	14.04%	
Return Requirement		\$478,405
Adjusted Balance Available for Return		239,959
Return Deficiency		238,446
Revenue Deficiency		238,684
MCC Tax at .1%		<u>238</u>

Income Available for Return \$238,446

REVENUE REQUIREMENT (DEVIATION)

30. As previously mentioned in this order, the Applicant has requested that the Commission deviate from its general rate-making principles for privately-owned public utilities (See Findings 8 thru 10). Under the Applicant's proposal, the Commission would not allow for recovery of interest expense through application of a rate of return on the rate base, which is the traditional method employed for recovery of this item of expense. Rather the Applicant would have the Commission move this item of expense "above the line" and allow recovery as an operating revenue deduction. Under the Applicant's proposal the revenue requirement of BWC would be as follows:

Operating Revenue	\$2,788,576
LESS	
Operating Deductions(F of F 27)	2,548,617
Interest Expense (F of F 20)	<u>525,470</u>
Revenue Deficiency(Exclusive of MCC Tax)	\$ 285,511
MCC Tax at .1%	285
Total Revenue Deficiency	\$ 285,796

31. The Commission must now decide which method of revenue requirement determination is appropriate for the Applicant. The Commission is reluctant to deviate from its standard determination of utility revenue requirements, because application of a rate of return base has been determined to be an acceptable method for determining fair and reasonable rates. The fact that the Applicant's debt capital exceeds its rate base does not, in the Commission's opinion, warrant deviation from standard rate making treatment. The Applicant's debt capital exceeding rate base does not alter the fact that only those assets employed to provide service to the consumer are properly considered in determining fair and reasonable rates.

32. The commission finds that the Applicant should be authorized an annual revenue increase in the amount of \$238,446.

#### SERVICE

33. The testimony presented regarding the sand problem experienced by consumers of the water utility was limited to the presentation made by Gary Mannix of BWC. Mr. Mannix testified as follows regarding sand related service calls:

"... I would like to address the sand situation. We had a slight increase in the number of calls this year. In almost all cases, the calls have been to change the screens in the wye strainers. These screens are extremely fine and plug with small suspended material that would pass through normal plumbing fixtures causing no problems.

...I feel that the sand problem is over and the calls that we are now getting are only because we have installed such fine screens in the strainers... I, therefore, feel that the sand discount should be eliminated." (Tr. Pgs. 8 & 9).

Absent testimony contradicting that of Mr. Mannix, relative to the sand problem and the associated rate differential, the Commission finds it appropriate to eliminate the rate differential for consumers having sand traps.

#### RATE DESIGN

34. The Applicant proposes to continue the current water rate structure, and generate the increased revenue determined appropriate in this order by increasing rates for all water services on a uniform percentage basis.

35. Mr. Walter Richter, Chairman of the Rocker Water

District, presented testimony during the public hearing, and included in that testimony was a request that the Commission authorize a 20% rate reduction for all sales of water to the Water District. It was Mr. Richter's assumption that if a 20% discount were implemented for the Water district then consumers purchasing water from the district would be paying approximately the same monthly charge as consumers connected to the BWC system.

36. The Commission would like to take this opportunity to examine Mr. Richter's assumption that a 20% discount on water sales to the district would result in consumers purchasing water from the district, at the same rate as consumers connected to the BWC system. On cross-examination, Mr. Richter stated that the district's average monthly bill was approximately \$200 to \$300 and that the district had approximately 45 connections. If we divide the average monthly bill of \$300 by the 45 connections, we determine that the average bill for a consumer residing within the district is approximately \$6.66 a month.

That average bill (\$6.66) should be compared with the average bill for a flat rate residential consumer connected to BWC's system. The average house would have 5 to 6 rooms with 1 bath and 1 toilet, under BWC's flat rate schedule, this consumer would pay a monthly rate of \$11.25 per month. As is clear from the Comparison of average billings, the consumer connected to the BWC system is paying a significantly higher rate for water service than the consumer connected to the district's system.

37. Absent a fully allocated cost of service study the Commission cannot determine what level of revenue contribution should be exacted from each customer



classification. Based upon the simple analysis presented in the preceding Finding of Fact, a 20% discount in the rate on water sales to the Rocker Water District is not justified.

38. The rate design proposed by the Applicant appears to equitably spread the increase among the various customer categories; therefore, the Commission accepts the Applicant's proposed rate design.

#### MISCELLANEOUS

39. In Order 4896a, the Commission discussed the Applicant's practice of providing free water service to certain consumers connected to its facilities and ordered the Applicant to discontinue this practice. Order 4896a provided that the Applicant would start assessing those consumers that had been receiving free water service one-third of the appropriate charge, and that subsequent rate orders would phase in the remaining two-thirds of the full charge.

Order No. 4977b, required that the Applicant start assessing consumers that had been receiving free water service two-thirds of the respective consumer's appropriate charge. This order should require full implementation of the appropriate charge for consumers who had previously received free water service from the Applicant, and the Commission finds full implementation appropriate.

40. There was considerable discussion on the record relative to the Applicant's capital structure, which consists of debt and negative equity. The Commission, in particular, expressed concern relative to the applicant's parent companies continuing to advance funds to the Applicant, and causing

those funds to be carried on the books of the Applicant as debt instead of equity. Until such time as there is an improvement in the capital structure of the Applicant, reflecting a mix of debt and positive equity, the Applicant will not have the capability to improve its financial performance or attain the financial ability to repay any of the principal amounts on its outstanding debt obligations.

The Commission is of the opinion that, since all outstanding debt obligations of the Applicant are due and payable to the parent companies, which are the equity investors, the parent companies should examine the possibility of converting a portion of the outstanding debt to equity in an effort to forestall the incurrence of additional operating losses by BWC and improve the overall financial health of the Applicant.

41. During the course of this docket the Applicant attempted to infer that the Commission delayed processing of its 1983 rate application and that this Commission's delay resulted in the Applicant having to increase the amount of funds it received as an advance from its parent company. The Commission takes exception to the Applicant's inference. The delay experienced in the 1983 proceeding was, in part, due to the Applicant's request that the public hearing be delayed until late October or early November. The following excerpts from a July 19, 1983 letter from Dennis Lopach, the Applicant's attorney, substantiates the request for a hearing delay:

"...we discussed the possibility of public hearings in early September in these cases. Subsequently, you and I have discussed the possibility of deferring those hearings until late October or early November...."

"A later hearing would allow the opportunity to study

certain aspects of the filing and determine if amendments are required."

The other mitigating circumstance that delayed processing of the application was the briefing schedule necessitated by the applicant's treatment of contributions in aid of construction.

Due to the aforementioned circumstances all parties, including the Applicant, agreed to a 60-day extension on the 9 month deadline provided for in Section 69-3-302(1), MCA.

#### RULES

42. The Applicant has proposed implementation and modification of certain rules of practice for the water utility. The Commission approves those rules as filed excepted as herein noted:

Rule S-14 proposes the implementation of a conservation fee for violations of sprinkling rules. The Commission is of the opinion that the recourse available to the Applicant (discontinuance of water service) is adequate for enforcement of sprinkling rules and, therefore, finds implementation of the fee inappropriate.

Rule S-16, paragraphs 3 and 4, discuss the liability of the water utility during periods of service interruption. The Commission's "General Rules of Privately-Owned Water Utilities" address this liability in Rule 38.5.2505 (3) and (4) The Commission finds that these rules adequately address the utility's liability and paragraphs 3 and 4 of the special rule should be deleted.

#### CONCLUSIONS OF LAW

1. The Montana Public Service Commission properly exercises

jurisdiction over the parties and subject matter in this proceeding. Section 69-3-102. MCA .

2. The Commission afforded all parties interested in this proceeding proper notice and an opportunity to participate. Section 69-3-303, MCA.

3. The Rate approved herein are reasonable, just and proper. Section 69-3-201, MCA.

#### ORDER

NOW THEREFORE, IT IS ORDERED THAT:

1. Butte Water Company shall file rate schedules which reflect an increase in annual revenues of \$285,796 for its Butte, Montana water service. The increased revenue shall be generated by increasing rates and charges to all customer classifications and assessment of the full appropriate charge for consumers previously receiving free water service.

2. The rates approved herein shall not become effective until approved by the Commission.

3. The revenues approved herein are in addition to, and not in lieu of, those approved in Order No. 5114.

4. The special rules proposed by Butte Water Company are approved except as provided in Finding of Fact No. 42.

5. DONE IN OPEN SESSION at Helena, Montana, this 10thday of June, by a vote of 3-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

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John Driscoll, Commissioner

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Howard L. Ellis, Commissioner

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Tom Monahan, Commissioner

ATTEST:

Trenna Scoffield  
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed (10) days. See ARM 38.2.4806.